



## **OXFORD ANALYTICA**

### **HUNGARY**

### **MONETARY TRANSPARENCY**

#### **Country Report 2005**

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5 Alfred Street  
Oxford OX1 4EH

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# HUNGARY



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2005	2004	2003	2002
Clarity of roles	●●●●	●●●●	●●●●	--
Open decision process	●●●●	●●●●	●●●●	--
Availability of information	●●●●	●●●●	●●●●●	--
Central bank accountability	●●●●●	●●●●●	●●●●●	--
<b>Score</b>	<b>4.25</b>	<b>4.25</b>	<b>4.50</b>	--

## OUTLOOK & COMMENTARY

The National Bank of Hungary (NBH) has continued to make steady progress towards the highest standards in monetary transparency. Many observers voiced concern over the changes to the NBH Act last year, which seemingly politicised the process of appointing Monetary Council members by allowing the prime minister to nominate four of them. In the event, however, the new members turned out to be recognised experts in their field, while their actions to date have been viewed as perfectly consistent with the NBH's established policy stance. Concerns of political interference led the central bank to improve transparency standards by publishing unattributed minutes and the voting record after Monetary Council meetings. This innovation should serve as an important guarantee of NBH independence even in the case that political pressures for monetary loosening increase again.

The NHB seems fully committed to further improvement in the quality of its publications, which will be of great importance at a time when the central bank can play a critical role in working towards timely fulfilment of the Maastricht criteria. Even if excessive polarisation is risky, open debate and quality research on the state and direction of economic policy will be important for the future prospects of Hungary.

## EXECUTIVE SUMMARY

### 4.25 Compliance in progress

Hungarian monetary transparency standards remain high and the National Bank of Hungary (NBH) is committed to increasing them further. Considerable progress has been made in improving the quality and range of NBH publications. Efforts have been made to ensure that the NBH's leading publication, the *Quarterly Report on Inflation*, serves as a concise and accessible reference on economic conditions and the central bank's projections. In addition, the NBH has begun to publish a quarterly briefing book containing the key economic data and forecasts in a summary form.

In spite of considerable resistance from the NBH, including a referral to the Constitutional Court, the NBH Act was amended at the end of last year and increased the influence of the government on the composition of the NBH's main policy-making body, the Monetary Council. Under the revised law, the prime minister is able to nominate four of the nine to eleven members of the Council. Concerned about the implications of the move, the NBH made an important contribution to higher transparency standards by deciding to publish unattributed minutes of the Council meetings, as well as the voting record after each Council meeting. In addition to the basic data on monetary policy making, the minutes provide concise data on the macroeconomic and financial market conditions in the country. The reform is designed to increase the accountability of individual Council members, and is likely to do so.

The fears of most observers appear to have been assuaged by the appointment of highly qualified professionals as the new members of the Monetary Council. Their actions to date have appeared fully consistent with the NBH's expected behaviour, given its policy statements and rules. However, some suspicions persist that a deterioration in the economic conditions facing Hungary might increase the pressure facing the Council. The likelihood of this remains relatively high at a time when fiscal discipline is loose and Hungary's prospects for meeting the Maastricht are criteria increasingly in question. The persistent fiscal problems have even led some to speculate about the possibility of a significant revision in foreign investor attitudes towards Hungarian securities.

The new appointments have not significantly improved the tense relationship between the NBH and the government, nor is significant change in this area likely under the current circumstances. While more cooperative policy making might well yield positive results, the NBH seems committed to playing its part in highlighting the risk inherent in the government's stance and the negative implications of a lack of economic reform for the country's euro-zone accession. While the authorities have stated their commitment to euro adoption in 2010, market expectations increasingly view 2014 as the likeliest date.

Hungary's overall rating remains unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS



Compliance in Progress

### The objectives and institutional framework of monetary policy

The institutional framework for monetary policy in Hungary is defined in the *Act LVIII:2001 on the Magyar Nemzeti Bank* (National Bank of Hungary, NBH) which complies with EU standards, although the *2004 Convergence Report* of the European Central Bank pointed out certain areas where further amendments will be needed in defining the NBH's relationship with the ECB.<sup>1</sup>

#### Central bank objectives and responsibilities

The NBH is responsible for the formulation and conduct of monetary policy with the primary objective of achieving and maintaining price stability.<sup>2</sup>

The central bank is further required to promote the stability of the financial system and to develop policies for its prudential supervision. The NBH has the exclusive right to issue currency. It is further responsible for the management of foreign exchange and gold reserves. It serves as banker to the government and as fiscal agent of the government. It has an advisory function in economic and financial policy and in international cooperation.<sup>3</sup>

The exchange rate regime is set by the government in agreement with the central bank. However, the NBH Act stipulates that this has to be done “without prejudice to the primary objective of the NBH to achieve and maintain price stability.”<sup>4</sup> The NBH alone is responsible for the implementation of exchange rate policy under the regime.<sup>5</sup>

#### Operational autonomy

The NBH's independence is explicitly established in the NBH Act, which states that the central bank shall “neither seek nor take instructions from the government or any other body.”<sup>6</sup> The government sets the exchange rate regime in agreement with the NBH, although day-to-day exchange rate policy is managed purely by the NBH.<sup>7</sup> In addition, the NBH and the government have since July 2003 jointly agreed the inflation targets to be pursued, a task previously assigned exclusively to the NBH. The targets are set in accordance with the macroeconomic projections of the government's *Convergence Programme*.<sup>8</sup>

According to the NBH Act, the central bank is required to support the government's economic policy “without prejudice to its primary objective.”<sup>9</sup> There have been repeated attempts to coordinate policy and in several cases, especially during financial market turmoil, the government has explicitly voiced support for decisions made by the Monetary Council. However, the positive steps have been repeatedly undermined by the openly confrontational relationship between the two sides, which has taken place against the backdrop of a highly politicised and polarised public debate. Governor Zsigmond Járαι of the NBH was appointed by the previous centre-right government in which he served as a minister of finance. His strong professional credentials notwithstanding, Járαι has not done much to hide his political views and has favoured people of a similar persuasion in his appointment policy. At the same time, the current centre-left government has frequently been openly critical of Járαι for failing to support its policy through monetary easing. Járαι has countered by accusing the government of a lack of fiscal discipline, which might jeopardise the adoption of the euro by 2010. Under the circumstances, effective cooperation between the NBH and the government has been difficult.<sup>10</sup>

Clearly frustrated with the situation, the government last year resorted to seeking ways of reducing Járai's influence. A previous attempt was made by re-establishing the NBH's Supervisory Board in October 2002, even though it had been abolished in 2001. The Board consists of political appointees, albeit all major parties are represented and several members are professional economists. The move was strongly resisted by the NBH but its practical impact has been minimal. Under the NBH Act, the Board is unable to influence the central bank in fulfilling its functions and does not appear to have done so even informally.<sup>11</sup>

In October 2004, however, three parliamentary deputies of the governing coalition proposed a revision to the NBH Act to change the appointment process and composition of the Monetary Council. Under the amendment, the prime minister was empowered to directly nominate four of the members with the president of the Republic responsible for the formal appointment. When the terms of two of the current deputy governors expire in 2007, they will not be renewed and the statutory size of the Council will fall to nine to eleven. No member of the Council will be eligible for nomination for three years after the expiry of their mandate. Under the current system, the governor makes all the nominations to the president of the Republic, subject to approval by the prime minister. The government has argued that the new procedure would enhance NBH independence. In contrast, the central bank expressed strong opposition to the move.<sup>12</sup> Similarly, the European Central Bank (ECB) commented that the pre-reform appointment process already provided an appropriate framework for the formulation of monetary policy and ensured the independence of the NBH. By implication, a change would therefore not be necessary. The government in response merely removed the most controversial part of the proposed amendment which would have resulted in the removal of two of the current deputy governors of the NBH from the Council.<sup>13</sup> Prime Minister Ferenc Gyurcsány, under the powers he gained under the amended NBH Act, appointed four new members of the Monetary Council in January. All members are professional economists who had most recently been active in scientific research or as in-house economists in the corporate sector.

The 2004 *Convergence Report* of the European Central Bank criticises the NBH Act for a provision that allows the Ministry of Justice to review draft NBH legal acts. Although the provisions limit the review to ensuring the constitutionality and the technical aspects of the drafts, the article is deemed to potentially contravene EU Treaty requirements on central bank independence. The ECB further questions the EU compliance of the legal requirement that the NBH governor and the Monetary Council members declare their wealth upon appointment and every two years thereafter. Under the NBH Act, a failure to do so, as well significant inaccuracies, can be deemed to represent serious misconduct which would lead to the suspension of Monetary Council membership.<sup>14</sup>

Hungary does not have a joint MoF-NBH working group for euro-zone entry, although collaboration does take place on the expert level. The government asked the NBH to draft parts of the 2004 *Convergence Programme*. NBH representatives are invited to the so-called economic cabinet to discuss issues related to the budget. However, the NBH does not publish a formal opinion on the government's budget proposal.<sup>15</sup>

## **Institutional relationship between monetary and fiscal operations**

### **Lending to government**

The relationship between monetary and fiscal operations is explicitly defined in the NBH Act, which states that the NBH may not finance the deficit of the state budget, or any state debt. Accordingly, it is not permitted to purchase securities from state institutions in the primary market. It is explicitly forbidden to issue credit to the government or any other public sector agency.<sup>16</sup>

### **Central bank involvement in the rest of the economy**

Representatives of the NBH may express an opinion on the budget proposal after its submission to the parliament, both to the government and to competent parliamentary committees. However, the opinion is not published as a separate document. In addition, the government is required to invite the NBH governor to attend meetings where the agenda contains issues of relevance to the central bank's remit.<sup>17</sup>

The NBH monitors the financial sector and publishes its findings in the *Report on Financial Stability*. It further cooperates closely with the Hungarian Financial Supervisory Authority in the area of banking supervision.<sup>18</sup>

The NBH may not legally hold any ownership interests in either domestic or foreign business associations not related to the NBH's activities.<sup>19</sup>

### **Central bank profit allocation**

An annual dividend, equal to the average profit from three preceding years, is paid to the government, with any excess profit transferred to a profit reserve. This reserve is then available to top-up the dividend payment should there be a shortfall in earnings.<sup>20</sup>

### **Agency roles performed by the central bank on behalf of the government**

The NBH serves as the banker to the government. Under the NBH Act, the central bank manages the accounts of the State Treasury (*Magyar Államkincstár*) and other government accounts specified by the Minister of Finance, as well as the accounts of the Hungarian Privatisation and State Holding Company (*Állami Privatizációs és Vagyonkezelő*) and of the Government Debt Management Agency ÁKK (*Államadósság Kezelő Központ*).<sup>21</sup>

A formal memorandum of understanding governs the relationship with ÁKK and the MoF. The NBH may also be mandated to raise loans in foreign exchange and securities and execute forward transactions (hedging) for the state. Ultimate responsibility for the management of state debt, however, rests with the government.<sup>22</sup> The key institution in this regard is ÁKK, which since its establishment in 1995 has progressively taken over responsibility from the National Bank for the issuing and management of Hungary's foreign debt, to add to its responsibilities for domestic debt. Since its separation from the State Treasury in 2001, the ÁKK operates as a joint-stock company under the supervision of the Ministry of Finance but with a high degree of autonomy.<sup>23</sup> The NBH now acts as the paying agent for the insurance of foreign-currency denominated debt. The relationship between the two entities is good and, at MoF request, the NBH governor appoints a permanent representative -- typically a NBH deputy governor or managing director -- to the ÁKK board of directors. He is supplied with all documentation pertaining to debt management but has no voting rights. ÁKK consults with the NBH in formulating its strategy. There is no longer any ÁKK-NBH collaboration in the area of analytical research.<sup>24</sup>

The NBH is allowed to act as an advisor and agent to the government in the securities market, and can be consulted before issuing securities on behalf of the state. ÁKK and the NBH both receive and review offers from investment banks for debt issues. They make independent choices and the ultimate responsibility goes to the MoF in the event of differences of opinion. Until this year, the NBH did swaps for ÁKK as a constant counterparty but this is no longer the case. According to ECB accounting rules, the position as a market intermediary can no longer be used.<sup>25</sup>

The NBH is allowed to express opinions on ÁKK management of government debt and has done so in the past. There are weekly middle-level meetings with the NBH that cover a broad range of issues.

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●● Compliance in progress

### The framework, instruments, and targets of monetary policy

#### Framework and monetary targets

The NBH Act stipulated the achievement and maintenance of price stability as the primary policy objective of the NBH. In order to meet this goal, the NBH in 2001 adopted a formal inflation-targeting regime. The mechanism is designed to set clear and binding targets, the attainment of which becomes the central goal of the central bank's actions. With this in mind, the NBH publishes a staff inflation forecast in the *Quarterly Report on Inflation* in order to make the policy-making process more transparent. The central bank has clearly signalled that persistent deviations between the forecast and the inflation target will trigger a policy response taking the form of an interest rate adjustment designed to reduce the gap. At the same time, the NBH is seeking to establish the inflation forecast as a credible "nominal anchor" so as to guide inflationary expectations in a way that will minimise the costs of disinflation. The inflation target set for December 2005 is 4% with a tolerance band of +/-1 percentage point, which is expected to provide flexibility in the event of unforeseen shocks. Under the government's *Convergence Programme*, this is expected to further decline to 3.5% in 2006 and to 3% thereafter.<sup>26</sup> No formal provisions exist for accountability and remedial action in the event of the NBH failing to achieve its inflation target.

The NBH prepares its inflation forecast on the assumption of unchanged exchange rates, oil, and futures prices. Historically, the NBH's performance in inflation targeting has been successful by regional standards. The targets were reached in 2001, 2002, and 2004. A sharp fiscal easing in 2003 led to the only recent instance of the target being missed.<sup>27</sup>

Unlike most other countries in the region, the NBH also targets the exchange rates, albeit officially subject to the primary goal of price stability. The current Hungarian exchange rate regime is compatible with, and modelled on, the ERM2 regime. The Hungarian forint is pegged to the euro around a central parity of 282.36 forints. The market rate is allowed to fluctuate within a +/-15% band currently set between 324.71 and 240.01 forints to the euro. In practice, fluctuations have been limited to the +/-7.5% range. The wider band was adopted in May 2001 and the central parity most recently modified (from 276.1 forints to the euro) in June 2003. Although market forces determine fluctuations within the band, interventions by the NBH are possible at any time. Such intervention is required when the exchange rate reaches the edge of the band. The minimum amount of an intervention is 4 million euros.<sup>28</sup> The central bank has loosened its reaction function to exchange rate fluctuations, in spite of the fact that exchange rate has been weaker than desired for a period of some six months.<sup>29</sup>

In practice, Hungary has had a very chequered record of trying to manage the system of dual targeting in the circumstances of relatively lax fiscal policy and an often-confrontational relationship between the government and the National Bank. The struggle to reconcile the dual goals has repeatedly strained the credibility of Hungarian monetary policy, even if the situation has improved during the past year with steady reductions in interest rates. Additional problems are created by communicating the inflation forecast, which is a staff projection that is not fully based on in-house models, and which is not explicitly endorsed by the Monetary Council.<sup>30</sup>

There is widespread disillusionment in Hungary about the dual targeting regime and many now feel that the interests of the country would have been better served by a flexible exchange rate. The International Monetary Fund this year



endorsed the position, although change at this point is seen as unlikely, not least because of the widespread reliance of Hungarian consumers on foreign currency-denominated borrowing.<sup>31</sup> The NBH still in 2003 favoured ERM2 accession at the earliest possible date and was in favour of remaining in the system for longer than two years. The position has been modified, however, and the NBH now advocates joining only if the government is seen as pursuing responsible policies. Many have voiced support for abandoning the pegged exchange rate in order to allow the exchange rate to find its market-determined level before ERM2 accession.<sup>32</sup>

The government has repeatedly pushed back the target date for the adoption of the euro as the national currency; the current goal is 2010. However, meeting this target will presuppose additional fiscal consolidation and structural reform, something that may well be compromised by the political business cycle. It is likely that improved policy coordination between the fiscal and monetary authorities would increase the probability of the goal being met. However, such collaboration must be seen as highly unlikely in the near term, specifically before the 2006 elections.<sup>33</sup>

### **Monetary instruments**

The NBH uses all the standard monetary policy instruments: deposits from credit institutions, collateralised lending, open market operations, security emissions, foreign exchange market intervention, interest rates, refinancing, and minimum reserve requirements. The most widely used instruments is a two-week deposit facility. Through setting its base rate for such deposits, the NBH influences its operative target, the three-month money market rate. To prevent volatility of inter-bank interest rates, the NBH maintains an overnight interest rate corridor of the base rates  $\pm 1\%$ . The central bank further uses quick tenders to reduce interest rate fluctuations. The reserve ratio currently stands at a relatively high 5%.<sup>34</sup>

## **The monetary policy-making body**

### **Monetary board**

The NBH Act establishes the Monetary Council as the supreme decision making organ of the NBH with the sole responsibility for all monetary policy decisions. Most importantly, the Council decides on the NBH's monetary policy stance by setting the base rate.<sup>35</sup>

Following an amendment to the NBH Act in 2004, the size of the Monetary Council was expanded this year by four new members nominated by the prime minister, albeit still appointed by the president of the Republic. Previously, the Council had been composed of seven to nine members: the governor, the vice governors, and experts nominated by the NBH governor, vetted by a relevant parliamentary committee, and appointed by the president of the Republic. Under the amended NBH Act, the size of the Council reverts to nine to eleven members after the terms of the current deputy governors expire. The new Council will have a governor and one deputy governor in addition to its regular members. With the exception of the vice president, who is appointed by the president of the NBH, all members are appointed by the president of the Republic.<sup>36</sup>

All members of the Council are required to have "outstanding theoretical or practical professional knowledge related to monetary, financial, and banking activities" and serve as employees of the NBH during their term. The appointments are made for a period of six years and do not have to be simultaneous. Under the revised NBH Act, members of the Council cannot be appointed to the Council again for a period of three years following the end of their term.<sup>37</sup> In spite of concerns about increased government influence on monetary policy through the appointments made by the prime minister, the individuals chosen are widely recognised for their professionalism and qualifications. At least to date, the appointments do not appear to have had a significant bearing on policy choices.



The minister of finance, or another duly authorised minister, can represent the government at Council meetings, albeit without voting rights. Voting at Council meetings is by simple majority and the Council will have a quorum when the majority of its members are present. The Council's work is prepared by an internal monetary policy committee, which typically meets every week to assess recent developments and future prospects. The committee is made up of the Council members, NBH managing directors, and related staff.

The Monetary Council has, as of June 2004, considered interest rate decisions at only one of its two monthly meetings. This second monthly meeting is followed by a press release explaining the central bank's decisions and the reasoning behind them. No press release is issued after the meetings which not devoted to interest rates.<sup>38</sup> Since 2005, the NBH publishes unattributed minutes, along with a voting record, of the Monetary Council meetings approximately three weeks after each meeting. The formal minutes are preceded by a brief overview of the current macroeconomic and financial market situation.<sup>39</sup> Many analysts viewed the innovation as a precautionary measure in the face of perceptions of increased government interference in monetary policy making. While the innovation is likely to increase the accountability of individual Council members, it also represents convergence towards the standards of many other EU countries. The reform has been welcomed by market analysts. The NBH is planning to study the impact of the decision on market behaviour. Statements by Monetary Council members to the media remain relatively infrequent.<sup>40</sup>

### **Advance meeting schedule**

The Council is required to meet twice a month, with additional meetings to be convened as necessary. An advance schedule is currently published for a full calendar year at a time and is available on the website.<sup>41</sup> Since July 2004, changes to the base rate are discussed only at the second scheduled meeting of each month. The decision was justified by international comparisons and the fact that the data bearing on interest rate decisions is seldom published more frequently than once a month.<sup>42</sup>

## **Public statements on monetary policy**

### **Periodic publications**

The NBH has a wide-ranging series of periodic publications and views regular communications with the markets as a key element of its transparency strategy. The *Annual Report* details the evolving macroeconomic situation and its implications for monetary policy and the exchange rate regime, as well as presenting the central bank's results.<sup>43</sup> It also outlines the NBH's monetary policy agenda, reviews changes in monetary policy instruments, and anticipates future changes, which may include reductions in the reserve ratio and reform of the required reserves system. The semi-annual *Report on Financial Stability* offers data pertaining to efforts to increase and maintain economic and financial stability.<sup>44</sup>

The central bank also produces a quarterly *Inflation Report*, which contains commentaries on the progress towards achieving its inflation target, inflation projections and considerations bearing on the decisions of the Monetary Council. As an important innovation this year, the *Inflation Report* now also includes a detailed analysis of the fiscal situation in Hungary. The format of the *Quarterly Report on Inflation* was revised in August 2004 to make it more compact and accessible. As of this year, the NBH also publishes a monthly *Chart Pack of Recent Economic and Financial Market Developments*, which provides concise information on key macroeconomic and business indicators. The central bank's forecasts are included as taken from the *Inflation Report*.<sup>45</sup>

The NBH has further published a comprehensive guide to *Monetary Policy in Hungary*. All these materials are translated into English and available through the NBH website.

The central bank uses a range of methods in its macroeconomic forecasting. Elements of these models have been published and the main assumptions and other information are discussed in the *Quarterly Report on Inflation*. A non-technical summary of the comprehensive structural model known as the Quarterly Projection Model (NEM) is available on the website. The NBH is planning to publish the entire model in the near future. The NEM model has been used to generate the projections included in the *Quarterly Report on Inflation* starting in February 2004.<sup>46</sup>

The NBH also includes Hungary's *Convergence Programme* on its publications site. Although formally prepared by the government, in pursuance of EU regulations, the NBH is consulted in the process. The objective of including the report on the webpage is to increase awareness of the preparations for euro-adoption, a goal to which the central bank remains strongly committed. In spite of the problematic fiscal situation, the NBH still favours euro-zone accession at the earliest feasible date of 2010.<sup>47</sup>

The central bank has produced a range of more popular publications with the explicit aim of explaining key aspects of monetary policy to the general public in a non-technical manner.<sup>48</sup>

### **Public hearings**

Decisions by the Monetary Council are publicly announced. The quarterly *Inflation Report* is presented to the public at a press conference. The NBH does offer a variety of mechanisms for interaction with market actors and independent analysis. The publication of the *Inflation Report* is followed by a meeting with independent market analysts. Forecasting models are revised in consultation with experts from the European Central Bank and there is an open academic debate about the NBH's forecasts. However, no mechanism of formal hearings or other attempts to canvass opinions in preparation for policy changes exists. Although the availability of information is both timely and ample, some of the problems surrounding monetary policy credibility have clearly been caused by ineffective and even inconsistent communication by the central bank leadership, and this represents an area for improvement.

The NBH governor appears annually before parliament to deliver the *Annual Report*. Additional appearances may be arranged as appropriate. This is generally deemed to constitute adequate oversight and some of our interviewees expressed scepticism regarding the ability of the Hungarian parliament to exert greater control effectively, given the polarised political climate.<sup>49</sup>

### **Regulations on data reporting by financial institutions to the central bank**

The NBH Act requires the central bank to "promote the stability of the financial system" and to "contribute to the development and smooth conduct of policies related to the prudential supervision of the financial system."<sup>50</sup> The Act further requires that the central bank publish all information related to the operation of the banking system, and provide regular and detailed information to the parliament and the government. The Act also empowers the NBH to request data, reports and balance sheets from financial institutions, and to conduct on-site inspections in the course of its data reporting activities. The NBH is authorised to initiate disciplinary, civil or criminal proceedings against institutions that it deems to have violated the law.<sup>51</sup> It publishes a biannual *Report on Financial Stability* evaluating the situation in the sector.<sup>52</sup>

The NBH assesses systemic risks and monitors at least the largest financial institutions. In practice, however, the responsibility for financial supervision is shared with the Hungarian Financial Supervisory Authority (*Pénzügyi Szervezetek Állami Felügyelete*, HFSA). HFSA was created in 1999 (with effect from 2000) and exists as an independent budgetary authority. It has the responsibility to promote transparency and the smooth operation of the financial markets. It maintains competitive market conditions through regular supervision and periodic inspections.<sup>53</sup> In practice, there is a high degree of coordination between the NBH and HFSA based on a formal memorandum of understanding that lays out the division of labour between the two bodies.<sup>54</sup> Under the NBH Act, "The NBH and the

HFSA shall exchange data and information which is necessary for the other organisation to perform its tasks.”<sup>55</sup> There is mutual reporting of findings from all on-site visits and regular joint meetings between the two organisations. The NBH and HSAF partially share a database and the central bank can initiate HFSA proceedings. Under the Act on Government Control of Financial Institutions, “Where so prescribed by law, the HFSA shall consult with or obtain the consent of the NBH prior to issuing or revoking authorisations or licenses.”<sup>56</sup> In addition to the regulatory framework, the high degree of foreign ownership of Hungarian banks -- some 80% of the capital of the sector -- is likely to promote compliance with international standards.<sup>57</sup>

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●● Compliance in progress

#### Release of central bank data

Hungary subscribes to the IMF Special Data Dissemination Standard (SDDS), and meets its specifications for the coverage, periodicity and timeliness of monetary data. An advance release calendar is posted at the IMF website.<sup>58</sup>

The analytical accounts of the NBH are derived from the central bank's balance sheet and show gross domestic and foreign assets and liabilities. This includes international reserves and claims on central government. The data are produced monthly, within one week of the reference period. An advance release calendar, giving six months notice, is disseminated through the NBH website.<sup>59</sup>

#### The central bank balance sheet

The NBH publishes its preliminary statistical balance sheet on its website on a monthly basis.<sup>60</sup> A consolidated balance sheet, together with an assessment by independent auditors, is included in the *Annual Report*.<sup>61</sup>

#### Lender of last resort

The NBH Act establishes that the central bank may grant extraordinary credit to financial institutions in circumstances that it deems may jeopardise the stability of the financial system. While there are no legislative requirements to do so, the NBH has typically announced the details of such support shortly after the event.<sup>62</sup> All lending is fully collateralised and any securities used are valued daily. As an alternative measure, the NBH can exempt a bank in difficulties from complying with the standard reserve requirements for a period of three months. Support is always provided in coordination with the Hungarian Financial Supervisory Agency.<sup>63</sup>

#### Public information services

The NBH maintains high-quality public information services through its website.<sup>64</sup> A comprehensive list of publications and data is available in both English and Hungarian. The central bank also disseminates press releases and the text of public statements. It also has a separate information services department.<sup>65</sup>

Copies of relevant legislation, including also English language texts of the NBH and Foreign Exchange Acts and the NBH Statutes, are available online and translations of other relevant legislation can be readily obtained through the central bank's information division.<sup>66</sup>

All central bank decisions are announced at a press conference and the NBH operates an internet 'chat room' following the publication of its *Inflation Report*. The staff of the NBH Economic Department answers questions by registered participants.

The NBH has a specialised library open to the public.<sup>67</sup>

#### 4. ACCOUNTABILITY AND ASSURANCE OF INTEGRITY BY THE CENTRAL BANK

●●●●● Full Compliance

##### Accountability before a designated public authority

The Act on the Central Bank requires the NBH governor to appear before the parliament annually for the purpose of presenting and discussing the *Annual Report*. Either the parliament or individual parliamentary committees may summon the NBH governor at will to discuss matters under his jurisdiction. He must, if so requested, present data on monetary and financial sector developments to the government. The parliament last year for the first time rejected the 2002 and 2003 annual report of the NBH. The votes, which largely reflected the political divisions in the legislature, were seen as politically motivated and effectively a protest against the high interest rates in the country. The reports submitted to the parliament had been approved by the State Audit Office, the NBH Supervisory Board, the external auditor PricewaterhouseCoopers, the minister of finance (who exercises the state's ownership rights in the NBH), and the parliamentary economic, budgetary, and finance committees.<sup>68</sup>

##### Financial Statement

The NBH's full results are included in its *Annual Report*.

##### Audited financial statement

Financial statements are included in the central bank's *Annual Report*, accompanied by an auditor's statement. A summary statement appears in the published *Annual Report*, while the version submitted to Parliament contains a more comprehensive account.<sup>69</sup>

##### External and internal audit

The NBH Act stipulates that an external accounting firm, which is appointed under a five-year non-renewable contract, must audit the central bank's annual report. This contract is currently held by PricewaterhouseCoopers.

The NBH has its own 16-person Internal Audit Department that is controlled by the Supervisory Board and reports to the Audit Committee and the Board of Directors. The department follows an annual audit plan approved by the Supervisory Board. The plan can involve any area of the NBH's activities, although a potential problem is created by the legal provision that prevents the Supervisory Board from reviewing the main operations of the central bank, including monetary policy, the management of reserves, currency issuance, etc. The Audit Committee issues recommendations that are followed by the adoption of a schedule for implementation. Compliance is verified within a year.

The State Audit Office (*Állami Számvevőszék*) is responsible for tasks related to the inspection of internal NBH operations with the sole objective of ensuring compliance with laws and regulations. It cannot perform a financial audit, not review any activities connected with monetary policy. The SAO may submit proposals to the general meeting of the NBH for the appointment or dismissal of the independent auditor. There is no formal mechanism for follow-up.<sup>70</sup>

## **Conduct of officials**

The NBH Act details the obligation on employees and officials to avoid conflicts of interest, including those arising from political affiliation and relations with credit institutions. Employees sign a confidentiality agreement, and are regarded as public officials from the point of view of applying criminal law.<sup>71</sup> Protection from personal liability is not considered necessary, since under Hungarian law, liability does not extend to employees of public institutions.

The NBH Act lays down rules to govern the appointment and discharge of the central bank's governor and vice-governors.<sup>72</sup>

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during visits to Hungary between 5 and 9 September and 1 and 4 November 2005:

### National Bank of Hungary

#### 7 September 2005

Zsolt Kondrát	Head	Department of Monetary Instruments and Markets
Gyula Barabás	Head	Department of Financial Analysis

### Ministry of Finance

#### 3 November 2005

Álmos Kovács	Deputy State Secretary	
Gizella Csonka	Chief Advisor, Deputy Head	Directorate of Fiscal and Monetary Policy Affairs
László Szabó	Counsellor	Division of Government Budget and Fiscal Policy

## ADDITIONAL INTERVIEWS

#### 5 October 2005

Werner Riecke	Managing Director	Derive Business Consultancy
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#### 6 September 2005

Emil Kemény	Head of Division	State Audit Office ( <i>Állami Számvevőszék</i> )
Gábor Pósch	Chief Advisor	State Audit Office
Márta Bartolák	Auditor	State Audit Office
Attila Boros	Auditor	State Audit Office

#### 7 September 2005

Péter Janza	Vice President	Government Control Office ( <i>Kormányzati Ellenőrzési Hivatal</i> )
Judit Erdei Szántóné	Head of Unit	External Relations

#### 8 September 2005

Györgyi Joó Tóth		
Zsuzsanna Balogh	Adviser, Treasury Commissioner	State Treasury
	Department	



**2 November 2005**

György Kovács	Head of Macroeconomic Research	Budapest Economics
László Csaba	Professor	Central European University
Gergely Fórián Szabó	Director	CA IB Fund Management Inc.

**3 November 2005**

István Bedekovics	Deputy Director, Department of National Accounts	Central Statistical Office
Sándor Pető	Correspondent	Reuters

## NOTES

<sup>1</sup> Act XVIII on the National Bank of Hungary (2001), passed by Parliament on 19 June 2001; *Convergence Report 2004*, Frankfurt am Main: European Central Bank, 2004, pp. 410-413, [www.ecb.int/pub/convergence/html/index.en.html](http://www.ecb.int/pub/convergence/html/index.en.html)

<sup>2</sup> NBH Act, Article 1.

<sup>3</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>4</sup> NBH Act, Article 11(2).

<sup>5</sup> NBH Act, Article 4(4).

<sup>6</sup> NBH Act, Articles 1 and 3

<sup>7</sup> NBH Act, Article 11(3).

<sup>8</sup> <http://english.mnb.hu/module.asp?id=130&did=2305>; *Magyarország konvergencia programja 2004*, Budapest: Magyar Köztársaság Kormánya, May 2004, [www.pm.gov.hu/web/home.nsf/portalarticles/FA288B2EBC71E8D8C1256E9800526833/\\$File/konvergencia-program.pdf](http://www.pm.gov.hu/web/home.nsf/portalarticles/FA288B2EBC71E8D8C1256E9800526833/$File/konvergencia-program.pdf)

<sup>9</sup> NBH Act, Article 3(2).

<sup>10</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>11</sup> "Hungary: Government/NBH monetary policy tensions," *Oxford Analytica Daily Brief*, 27 January 2003; <http://english.mnb.hu/module.asp?id=130&did=433>

<sup>12</sup> [www.portfolio.hu/en/tool/print/tdp?k=2&I=2286](http://www.portfolio.hu/en/tool/print/tdp?k=2&I=2286)

<sup>13</sup> [www.ecb.int/ecb/legal/1341/1345/html/index.en.html](http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html): Opinion on a law amending the Law on Magyar Nemzeti Bank (CON/2004/35) Hungary, 4.11.2004.

<sup>14</sup> *Convergence Report 2004*, pp. 410-411; NBH Act, Article 60.

<sup>15</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>16</sup> NBH Act, Article 19 (3)-(4); "The role of the Magyar Nemzeti Bank in the EU accession process," [www.mnb.hu](http://www.mnb.hu)

<sup>17</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>18</sup> NBH Act, Articles 43, 44.

<sup>19</sup> NBH Act, Article 69.

<sup>20</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>21</sup> NBH Act, Article 15.

<sup>22</sup> Act on Public Finances (Act XXXVIII of 1992), Article 113/A.

<sup>23</sup> [www.akk.hu](http://www.akk.hu)

<sup>24</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>25</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>26</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_monetarispolitika&ContentID=3027](http://english.mnb.hu/Engine.aspx?page=mnben_monetarispolitika&ContentID=3027); *Convergence Programme of Hungary 2004*, Budapest: Government of Hungary, 2004, p. 13.

<sup>27</sup> "ANALYSIS – NBH vs. analysts – Who is best in region at projection inflation?," *Portfolio.hu*, 29 March 2005, [www.portfolio.hu/en/cikkek.tdp?k=2&i=3495](http://www.portfolio.hu/en/cikkek.tdp?k=2&i=3495); "Hungary better in inflation targeting than Czechs, Poles," *Portfolio.hu*, 29 March 2005, [www.portfolio.hu/en/cikkek.tdp?k=2&i=3733](http://www.portfolio.hu/en/cikkek.tdp?k=2&i=3733)

<sup>28</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_monetarispolitika&ContentID=3032](http://english.mnb.hu/Engine.aspx?page=mnben_monetarispolitika&ContentID=3032)

<sup>29</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>30</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>31</sup> "Hungary: Selected Issues," *IMF Country Report*, No. 05/215, June 2005, International Monetary Fund, Washington, D.C.; "Hungary: 2005 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion," *IMF Country Report*, No. 05/213, June 2005, International Monetary Fund, Washington, D.C.

<sup>32</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>33</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.

<sup>34</sup> <http://english.mnb.hu/module.asp?id=113&did=1209>

<sup>35</sup> [http://english.mnb.hu/dokumentumok/jegybanktorv\\_en.pdf](http://english.mnb.hu/dokumentumok/jegybanktorv_en.pdf)

<sup>36</sup> "Hungary Parliament approves final version of central bank law," *Portfolio.hu*, 15 December 2004, [www.portfolio.hu/en/cikkek.tdp?k=2&I=2572](http://www.portfolio.hu/en/cikkek.tdp?k=2&I=2572)

<sup>37</sup> NBH Act, Article 11, 49(3), (5).

- <sup>38</sup> [http://english.mnb.hu/engine.aspx?page=mnben\\_monet\\_kozlem](http://english.mnb.hu/engine.aspx?page=mnben_monet_kozlem); *Quarterly Report on Inflation*, Budapest: National Bank of Hungary, August 2004, pp. 81-2; Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
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- <sup>40</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- <sup>41</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_monetarisanacs&ContentID=2996](http://english.mnb.hu/Engine.aspx?page=mnben_monetarisanacs&ContentID=2996)
- <sup>42</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- <sup>43</sup> *Annual Report (Business Report and Financial Statements of the Magyar Nemzeti Bank) for 2002*, [http://english.mnb.hu/dokumentumok/eves\\_jelentes\\_2002\\_en.pdf](http://english.mnb.hu/dokumentumok/eves_jelentes_2002_en.pdf)
- <sup>44</sup> <http://english.mnb.hu/modulei.asp?id=140>
- <sup>45</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_egyebkiad\\_en&ContentID=0](http://english.mnb.hu/Engine.aspx?page=mnben_egyebkiad_en&ContentID=0)
- <sup>46</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_elorejelzo\\_modszerek&ContentID=5056](http://english.mnb.hu/Engine.aspx?page=mnben_elorejelzo_modszerek&ContentID=5056); Interviews conducted in Budapest, 6-8 September and 2-3 November 2005. Other publications include: Jakab M. Zoltán and Kovács Mihály András, "Magyarország a NIGEM modellben," *MNB Füzetek*, 2002/3, 2002. január; Zoltán M. Jakab and Mihály András Kovács, "Hungary in the NIGEM model," *NBH Working Paper*, 2002/3, April 2002; Zoltán M. Jakab and Mihály András Kovács, "Explaining the Exchange Rate Pass-Through in Hungary: Simulations with the NIGEM Model," *MNB Working Paper*, 2003/5, April 2003.
- <sup>47</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_konvergenciajelentes&ContentID=0](http://english.mnb.hu/Engine.aspx?page=mnben_konvergenciajelentes&ContentID=0)
- <sup>48</sup> [www.mnb.hu/engine.aspx?page=tanulmanyalyazat](http://www.mnb.hu/engine.aspx?page=tanulmanyalyazat)
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- <sup>50</sup> NBH Act, Article 4(3).
- <sup>51</sup> NBH Act, Articles 28, 29.
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- <sup>53</sup> [www.pszaf.hu/english/start.html](http://www.pszaf.hu/english/start.html)
- <sup>54</sup> NBH Act, Articles 43, 44.
- <sup>55</sup> NBH Act, Article 44.
- <sup>56</sup> Act CXXIV:1999 on Government Control of Financial Institutions, Article 6(c).
- <sup>57</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- <sup>58</sup> <http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=HUN>
- <sup>59</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005; [http://english.mnb.hu/engine.aspx?page=mnben\\_statistikak](http://english.mnb.hu/engine.aspx?page=mnben_statistikak)
- <sup>60</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_elozetes\\_statistikai\\_merleg&ContentID=0](http://english.mnb.hu/Engine.aspx?page=mnben_elozetes_statistikai_merleg&ContentID=0)
- <sup>61</sup> [http://english.mnb.hu/Engine.aspx?page=mnben\\_month\\_en&ContentID=0](http://english.mnb.hu/Engine.aspx?page=mnben_month_en&ContentID=0); [http://english.mnb.hu/engine.aspx?page=mnben\\_evesjel](http://english.mnb.hu/engine.aspx?page=mnben_evesjel)
- <sup>62</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005.
- <sup>63</sup> "Hungary: Financial System Stability Assessment Follow-up, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, Securities Regulation, Insurance Regulation, and Payment Systems," *IMF Country Report*, No. 02/112, June 2002, International Monetary Fund, Washington, D.C.
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- <sup>68</sup> "Hungary Parliament rejects central bank annual reports," *Portfolio.hu*, 28 September 2004, [www.portfolio.hu/en/cikkek.tdp?k=2&I=1559](http://www.portfolio.hu/en/cikkek.tdp?k=2&I=1559)
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- <sup>70</sup> Interviews conducted in Budapest, 6-8 September and 2-3 November 2005; Act XXXVIII:1989 on the State Audit Office, Articles 3, 16(2), 17(1), (4), [www.asz.gov.hu/C1256D89002F54FF/2D6B8D414155A72DC125675900347471/13F91D5F755D6296C1256DDD005572C8/\\$FILE/Legislation.pdf](http://www.asz.gov.hu/C1256D89002F54FF/2D6B8D414155A72DC125675900347471/13F91D5F755D6296C1256DDD005572C8/$FILE/Legislation.pdf)
- <sup>71</sup> NBH Act, Articles 54-58.
- <sup>72</sup> NBH Act, Articles 49-52.